No. 15942

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

RICHARD DOUGLAS FURNISH and EMILIE FURNISH FISHER,

Petitioners and Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent and Appellee.

Petition to Review a Decision of the Tax Court of the United States.

APPELLANT RICHARD DOUGLAS FURNISH'S OPENING BRIEF.

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Statement of the Case.

This is an appeal from the decision of the Tax Court of the United States, adjudging the petitioner Richard Douglas Furnish indebted to the United States for deficiencies in income tax and additions to tax for fraud, exclusive of interest, as set forth in the following table:

Year	Deficiency	Addition to Tax for Fraud	Total
1939-42	$ 35,284.58	$ 17,647.29	$ 52,931.87
1943	25,063.13	12,531.56	37,594.69
1944-48	266,856.01	135,509.77	402,365.78
1949	5,577.02		5,577.02
	$332,780.74	$165,688.62	$498,469.36

[Tr. of R. pp. 112-113.]

NOTE: (The Hill Audit is referred to in the Transcript of Record as Exhibit 5, whereas it should be designated as Exhibit V.)

Jurisdiction.

The jurisdiction of this Court is invoked under Title 26, United States Code, Section 7482(a), (b)(1).

The pleadings relied on are Petitions, Answers, Amendments to Answer, Replies, Petition for Review, Statement of Points on Appeal, under Docket Nos. 51416 and 51417, and Transcript of Proceedings. [Tr. of R., pp. 15-27, 28-51, 55-58, 58-63, 72-74, 69-70, 116-118, 124, 125-491.] The tax returns for the years involved were filed with the Collector for the Sixth District of California. [Exs. A to I.]

Statement of Facts.

Richard Douglas Furnish, hereinafter called petitioner, practiced medicine during the years in question in Los Angeles, California. Returns for the years involved herein were filed with the Collector for the Sixth District of California. [Petitions and Answers, Exs. A to I, Tr. of R., p. 126.]

The returns for the years 1939 to 1942 inclusive were signed by both petitioner and his wife. [Exs. A and B, Tr. of R., p. 126.]

Mrs. Funk (formerly Mrs. Furnish) was granted an interlocutory decree of divorce from the petitioner on December 11, 1944. [Tr. of R., p. 149.]

Herman Duelke was business manager for petitioner from November 1, 1945 until May, 1947. At petitioner's instructions, he purchased the Hinton Arms Apartment house at Sixth and Hobart for petitioner, taking title in his name so he could handle all papers if there were a sale. The money to purchase the property was given by petitioner to Mr. Duelke, and Mr. Duelke gave a quit-

claim deed in blank to petitioner. Shortly before May, 1947 Mr. Duelke called Edward Anspach and executed an agreement of sale under a power of attorney, without notifying the petitioner. The petitioner was disturbed about the transaction when he learned of it, and Mr. Anspach learned the next week that Mr. Duelke's employment was terminated. Mr. Anspach suggested that Mr. Duelke go into the real estate business. Mr. Duelke denied the transaction and conversation with Mr. Anspach. [Tr. of R., pp. 162-165, 389-392, 451-458.]

Following petitioner's instructions, Mr. Duelke purchased property at 5718 Hollywood Boulevard for the petitioner, taking title in his name and giving a quitclaim deed signed in blank to the petitioner. Approximately $25,000.00 was deposited in escrow to purchase this property and this amount was turned over to Mr. Duelke by petitioner in currency of small denominations. [Tr. of R., pp. 165-166.]

Petitioner also owned an interest in property located at 57th and Hoover Streets although title was held in the name of R. (Rene) M. Scanlan, an aunt of petitioner. This interest was sold to Dr. Boris Levin in September 1946 for a consideration of $7,525.00, with expense of sale of $193.13. Mr. Duelke represented the petitioner at the escrow proceedings on the sale of this property. The proceeds from the sale of this property were paid by check drawn to the order of Mrs. R. (Rene) M. Scanlan and turned over to Mrs. Scanlan. This same check endorsed by Mrs. Scanlan was later given to Mr. Duelke by the petitioner to pay for architectural work done on the 5718 Hollywood Boulevard property owned by petitioner. The property at 57th and Hoover Streets was

owned by petitioner; he eventually received the proceeds of the sale of such property, yet failed to report the gain on such sale on his income tax returns. The cost of such property to petitioner was $3,938.83. [Tr. of R., pp. 167-169, 275; Stip. of Facts, par. 3(a)(1)-(a)(4); Pet. Ex. 1, Schedule 4; Ex. F.]

The petitioner acquired property at 401 North Vermont in April 1944. The funds used to purchase this property were advanced by or for petitioner through a Dr. Gideon Ramseyer and title was placed in Dr. Ramseyer's name at the start of the escrow. Petitioner had Dr. Ramseyer sign a quitclaim deed. The total purchase price for such property was $42,195.15. Before the close of the escrow, title was transferred to the name of Elodia Sullivan. [Stip., par. 3(c)(1); Pet. Ex. 1, Schedule 4; Tr. of R., pp. 197-203.]

Title to the 401 North Vermont property was still held in the name of Elodia Sullivan when the property was sold in May 1948 for the contract price of $131,500.00. The cost of such sale was $6,879.70. [Stip., par. 3(c)(2).]

Elodia Katherine Sullivan, former employee of petitioner, has known him since 1931. She married in 1944 and her name became Douglas. She was divorced in 1949. [Tr. of R., pp. 224-227.]

Elodia Katherine Douglas, nee Sullivan, received $37,-120.30 in currency and a note in the amount of $87,500.00 secured by a trust deed upon the sale of the property in 1948. The note was paid off in currency including interest in January of 1949, amounting to approximately $90,000.00. Mrs. Douglas was acting for and under the

instructions of petitioner in taking title to the property in her name and receiving the proceeds from the sale thereof. [Stip., par. 3(c); Tr. of R., p. 209.]

The long term capital gain from the sale of the 401 North Vermont property and the interest received on the note were reported on a 1948 income tax return filed under the name of Elodia Sullivan. While Mrs. Douglas, nee Sullivan, was living at 3807 W. Sixth Street, Los Angeles, at the time, the return was filed under the address 1715 Micheltorena, Los Angeles. This was the home address of Eugene Scanlan, a relative through marriage and a patient of petitioner. [Ex. M; Tr. of R., pp. 205-209, 230, 305.]

In 1947, acting under petitioner's instructions, Mrs. Douglas purchased for him in her name 1000 shares of Thomas Steel Company common stock. In 1948, following petitioner's instructions, Mrs. Douglas purchased for him in her name an additional 1000 shares of Thomas Steel Company common stock from the proceeds of the sale of the 401 North Vermont property. [Pet. Ex. 1, Schedule 3; Tr. of R., pp. 210-211, 214.]

The dividends received in 1948 on the Thomas Steel Company common stock were received and reported by Mrs. Douglas on a 1948 income tax return filed under the name of E. Kathryn Douglass. On this return Mrs. Douglas listed her correct address of 3807 W. Sixth Street, Los Angeles. [Ex. L; Tr. of R., pp. 207, 210-211, 229-230.] Dividends were also paid on this stock in 1947 and 1949. [Tr. of Rec., pp. 220, 229-230; Standard and Poor's Corporations, 1947 Annual Dividend Record.]

The major portion of the proceeds from the sale of 401 North Vermont, amounting to approximately $127,000.00

in currency, was distributed by Mrs. Douglas at petitioner's instructions as follows:

$45,000.00	(Check to Bernard Lippman)
20,000.00	(Check to Bernard Lippman)
1,837.52	(State income tax on sale of 401 North Vermont as reported by Mrs. Douglas)
17,953.45	(Federal income tax on sale of 401 North Vermont as reported by Mrs. Douglas)
19,953.65	(Purchase of 1000 shares of Thomas Steel Company common stock)
10,000.00	(Loaned to Dr. Gideon Ramseyer)

[Ex. N; Tr. of R., pp. 211-214; Ex. 1, Schedule 3; Ex. B of Ex. 1.]

Petitioner caused the titles to his property known as the Hinton Arms on Hobart and Sixth Streets and the property at 5718 Hollywood Boulevard to be transferred to the name of Mrs. Douglas. [Tr. of R., pp. 216-217.]

Mrs. Douglas transferred title to this property and to the Thomas Steel Company stock to the petitioner after her question and answer statement to the Internal Revenue Service in November 1949. [Tr. of R., pp. 217, 220.]

The checks for $45,000.00 and $20,000.00 were given to Lazard Lippman by petitioner. They were deposited in the San Pedro bank account of Bernard Lippman on March 15, 1949. On March 24, 1949, Bernard drew a check on his account for $65,000.00 payable to his brother, Lazard. Lazard then cashed this check in San Pedro, receiving currency in twenty dollar denominations. This currency was then delivered to petitioner by Lazard. The Lippmans participated in this transaction solely as an accommodation to the petitioner who wanted the checks

cashed out of town and wanted to receive currency in small denominations. [Tr. of R., pp. 232-234, 334-336.]

Petitioner acquired real property at Florence Avenue and Crenshaw Boulevard, Los Angeles, in 1944, at a cost of $25,737.31. The purchase negotiations were handled by John LeGrand, a friend of petitioner, and title to such property was taken in the name of C. T. Scanlan, a cousin of petitioner. [Stip., par. 3(b)(1); Tr. of R., pp. 296-297; Ex. 1, Schedule 4.]

The Florence and Crenshaw property was sold in 1947 for $60,000.00, with costs of $11,568.45. C. T. Scanlan received the proceeds of the sale and turned them over to petitioner. The gain on the sale of this property was reported on the 1948 income tax return filed by C. T. Scanlan and petitioner paid C. T. Scanlan in cash for the amount of tax due to including such sale in Scanlan's return. [Stip., par. 3(b)(2); Ex. P; Tr. of R., pp. 305-307, 311.]

By the use of nominees to report the gains from the sale of the 401 North Vermont and Florence and Crenshaw properties a smaller income tax was paid than would have been paid if the petitioner had included the capital gains in his income tax returns. The "25% capital gains" tax does not necessarily apply to all capital gains, it depending on the amount of total taxable income of the taxpayer. [Ex. U.]

John LeGrand purchased stock of the Suburban Hospital for the petitioner in 1943 and 1944, receiving currency in small denominations from the petitioner for the purchase. Title to this stock was taken in the name of C. T. Scanlan. [Tr. of R., pp. 295-297, 300-301; Ex A of Ex. 1.]

Petitioner acquired stock in the Parkview Hospital in 1942. This stock was placed by petitioner in the name of G. E. Flowers, his former employee. The following dividends were paid on the stock of Parkview Hospital to petitioner or his nominee:

1944	1946	1947
$2,000.00	$2,500.00	$250.00

Petitioner failed to report these dividends in the returns filed for such years. [Ex. T; Tr. of R., pp. 338-345; Exs. R, S, D, F, G.]

Petitioner followed the practice of sending patients' checks to his sister in Kansas City where she cashed the checks and accumulated the currency for petitioner. Some time prior to 1946 the accumulated currency amounting to approximately $25,000.00 was returned to petitioner by express. Petitioner continued the practice of sending patients' checks to his sister to be converted into currency, and in the latter part of 1947 the petitioner's sister personally returned an additional $25,000.00 in accumulated currency to him. [Tr. of R., p. 161; Ex. J.]

Petitioner carried bank accounts in the names of employees and relatives. The accounts carried in the name of Mr. Duelke carried the capacity of Mr. Duelke as business manager or trustee, and the petitioner's business address was used as the address of Mr. Duelke. There were small accounts in the names of relatives. [Schedule 2 of Ex. 1; Tr. of R., pp. 185-186.]

At the start of the investigation of petitioner by agents of the Internal Revenue Service in January of 1949, the petitioner stated to the special agent that he never bought or sold any real estate in California at any time, nor had he asked anyone else for the use of their name in the

purchase or sale of a parcel of real estate. In fact the petitioner had engaged in numerous real estate transactions buying and selling property through nominees, and at the time of the interview owned three pieces of property held in the names of nominees. [Tr. of R., pp. 353-354; Ex. 1, Schedule 4.] However, the petitioner's 1946 tax return showed a sale of real property known as the Bonnie Brae Medical Building. [Tr. of R., p. 393.]

During the same interview, when confronted with this 1946 income tax return showing income from rents from the Hinton Arms Apartment (3807 W. Sixth Street, Los Angeles), petitioner stated to the special agent that he did not own the Hinton Arms Apartment, that it was the property of his business manager, Mr. Duelke, and that he had leased it from his business manager. In fact the petitioner was the real owner of the Hinton Arms and Duelke was the mere nominee of petitioner. [Tr. of R., pp. 354-355, 163, 195-196; Ex. 1, Schedule 4.]

Mr. Duelke tried to install a record system, but petitioner would not allow him to do so. [Tr. of R., pp. 173-174.]

Mr. Duelke claimed that petitioner told him he had removed his records when he had been investigated by the Bureau of Internal Revenue previously, but in fact a previous investigation by the Bureau of Internal Revenue was a 1948 audit covering the tax year of 1945, on account of alimony paid by the petitioner; and there had been an audit in 1945 for the years 1943 and 1944 that did not result in a change of the tax liability for those years. [Tr. of R., pp. 175-176, 322, 433-434, 437-438.]

No set of books adequately reflecting income was maintained by the petitioner. In the initial stages of the in-

vestigation, the agents attempted to determine petitioner's correct income from payments disclosed by patient history cards maintained in petitioner's office. It became apparent to the agents that not all the cards were available. When questioned concerning this, the petitioner stated to the agents that certain files were lost in moving the petitioner's office. Subsequently petitioner hired an attorney who stated that it was to the interest of his client to cooperate with the government and that there would be no longer a claim of lost files. All the files were then made available to the investigating agents. [Tr. of R., p. 357.]

Petitioner's attorney employed a certified public accountant, Harry K. Hill, to make an audit for the purpose of determining as nearly as possible the amount of gross income received by petitioner from his patients over the years 1939 to 1948, inclusive, as disclosed by the patient record cards maintained in petitioner's office. A typical patient record card contained the name of the patient, the medical history and treatment afforded the patient, and the amounts and dates of payments made by the patient. These cards were used by petitioner's office staff as the basis of preparing bills sent out to the patients. [Tr. of R., pp. 357-358, 367-368, 467-469, 479.]

Mr. Hill, in making his audit, examined the patients' record cards. He consulted with Mrs. Wheeler, and on a few cards with Dr. Furnish, according to Revenue Agent Mr. Ness. [Tr. of R., pp. 409-410.]

Mr. Hill's report was turned over to the Internal Revenue Service by petitioner's attorney. Agent Ness made a check on Mr. Hill's report as follows:

In Transfer File No. 1 he checked 75 cards in the letters A and B, of which there were 700, and did not check

the rest of the alphabet; in Transfer File No. 2 he checked 200 cards in the letter P, of which there were 1,200, and did not check the rest of the alphabet; in Transfer File No. 2A he checked 150 cards in the letter E, of which there were 1,300, and did not check the rest of the alphabet; in Transfer File No. 3 he checked 200 cards in the letters A and C, of which there were 600, and did not check the rest of the alphabet; in Transfer File No. 4 he checked 150 cards at random, of which there were between 1,200 and 1,300; in Transfer File No. 4A he checked 50 cards at random, of which there were between 900 and 1,000; in Transfer File No. 5 he checked 75 cards at random, of which there were 500. [Tr. of R., pp. 397-399.]

The gross receipts derived by the petitioner from his medical practice for the years 1939 to 1948 inclusive, as disclosed by the Hill Report, and as compared to the gross receipts from his patients, as reported by petitioner in his income tax returns, are as follows:

Year	Gross Receipts Reported	Gross Receipts Per Hill Report
1939	Return unavailable	$ 17,720.88
1940	Return unavailable	27,734.16
1941	$ 20,826.00	48,685.06
1942	25,642.00	66,252.56
1943	21,374.46	106,558.90
1944	26,521.50	107,230.58
1945	41,188.31	93,621.83
1946	55,493.08	141,542.82
1947	32,831.11	110,695.16
1948	57,330.03	81,892.84

[Exs. V, A-H.]

A net worth statement reflecting assets, liabilities and nondeductible expenses of petitioner for the years 1939 to 1948 was prepared by petitioner's accountant. This statement was introduced by petitioner at the trial and petitioner contends that such net worth statement is true and correct. Petitioner's net income for the years 1939 to 1948 reflected by such statement as compared to the net income reported by petitioner in his income tax returns, is as follows:

Year	Net Income Reported	Net Income per Petitioner's Net Worth Statement
1939	$ 4,555.56	$30,773.28
1940	5,615.83	58,541.04
1941	7,632.84	55,529.22
1942	8,477.53	56,770.86
1943	6,884.68	55,685.22
1944	12,134.10	19,728.82
1945	26,950.18	53,847.59
1946	18,212.16	50,666.92
1947	115.81	74,389.45
1948	17,828.99	73,922.44

[Stip., par. 4, 5; Exs. 1, 2; Exs. A-H, X, Y; Tr. of R., pp. 375-376.]

The net worth statement submitted by petitioner does not make the proper adjustment for two automobiles, one Pontiac and one Ford, which were disposed of by petitioner. The petitioner made a gift of the Ford, which had cost him $500 in 1941. While this asset was dropped from his net worth statement, it was not included as a gift in the nondeductible expenditures schedule. Thus, net income of 1941 should be increased by $500.00. The Pontiac, which had cost petitioner $900.00, was trans-

ferred to petitioner's wife in 1944 under the property settlement agreement. Petitioner's net worth statement should be adjusted to reflect this item in the nondeductible expenditures schedule in 1944, thus increasing net income of 1944 by $900.00. [Ex. 1, Schedule 5, Item (3); Ex. 3, par. 2; Tr. of R., pp. 276-278, 326-328.]

Petitioner's net worth statement properly reduces net income of 1944 by deducting $10,800.00, representing cash payments to petitioner's wife under the property settlement agreement. Respondent contends that petitioner's net worth statement improperly reduced the net income of 1944 by deducting the $10,800.00. [Ex. 1, Item (1), Schedule 1, p. 1; Tr. of R. pp. 379-382.]

Petitioner's net worth statement does not reflect the gift by petitioner to Mrs. Douglas of the dividends on the Thomas Steel Company common stock. This gift amounting to $2,592.00 should be added to petitioner's nondeductible expenses schedule for 1948, thus increasing net income for 1948 by this amount. [Ex. 1, Item (3); Tr. of R. pp. 329, 210, 220.]

Petitioner graduated from medical school in 1925 and practiced in Florida until 1931. Internal Revenue records in Florida reveal that petitioner filed no returns for 1925, 1926, 1927, 1930 or 1931 and that he filed returns for the years 1928 and 1929 showing no tax due. In 1931 one of petitioner's automobiles was repossessed. Petitioner and his family then moved to Scoby, Montana, a small town where petitioner practiced for approximately two years. [Tr. of R. pp. 140-142, 155; Ex. Z.]

For the next two years, petitioner traveled extensively engaging in the business of selling serums, the principal serum being used for the injection treatment of hernia. During this period of time, petitioner's family moved to

Los Angeles where his wife rented an inexpensive house and purchased secondhand furniture. In order to support the family, petitioner's wife had to invest the small proceeds she had received from her father's insurance in purchasing medicine that was sold from the home. Petitioner's wife was unable to keep up the payments on the secondhand furniture which was repossessed. Petitioner then joined his family in Los Angeles and they moved to a furnished two bedroom apartment which was rented for $35.00 a month. Petitioner, his wife and four children lived in that apartment for several years, until he purchased a residence at 121 Highland Avenue. Petitioner borrowed $1000.00 to make the down payment on the house in December 1938. [Tr. of R. pp. 142-144, 444-445; Ex. "D" of Ex. 1.]

The petitioner commenced the practice of medicine in Los Angeles in 1936. Due to the fact he was not a member of the Los Angeles County Medical Association the petitioner had difficulty in securing hospital facilities for his patients. In 1942 and 1943 petitioner finally acquired interests in two hospitals. [Tr. of R. pp. 143, 200-201; Ex. T; Ex. "A" of Ex. 1.]

Petitioner filed income tax returns for 1944, 1945, 1948 and 1949 on March 15, 1945, March 15, 1946, March 15, 1949, and May 15, 1950, respectively. Petitioner or his duly authorized representative filed consents extending the five-year statute of limitations for 1944 and 1945 to June 30, 1954, and extending the three-year statute of limitations for 1949 to June 30, 1954. The notice of deficiency for 1944, 1945, 1948 and 1949 was mailed on September 11, 1953. [Stip., pars. 1 and 2; Consents attached to Exs. D, E and I; Ex. W; Ex. A of Petition in Docket 51417.]

After a plea of *nolo contendere,* petitioner was convicted by the District Court, Southern District of California, Central Division, on two counts for violation of Section 145(b), Internal Revenue Code of 1939, such counts representing the years 1947 and 1948. [Ex. AA.]

All property that was carried in the names of nominees is included in Exhibit 1, petitioner's net worth statement. [Tr. of R. p. 169; Ex. 1.] Petitioner's accountant in preparing Exhibit 1 made an exhaustive search, checked all possible investments and received the help of petitioner in doing so. Internal Revenue Service accepted the reports prepared by petitioner's accountant in preparing the net worth statement, and did not discover any additional investments. [Tr. of R. pp. 257-258, 264-267.]

Exhibit 2, being the computation of tax based on petitioner's net worth statement, takes into account the restoration of $4,800.00 yearly alimony for the last four years. [Tr. of R. p. 318.]

The method employed by Mr. Hill in preparing the Hill Report, and the method used by Revenue Agent Ness in checking the Hill Report (Analysis of patients' Record Cards) assumed that a wavy line under a figure on the patient's record card indicated payment; and that the words "paid in full" indicated the total amount was collected, without checking to see whether the money had actually been collected; and that the word "paid" stamped on a card indicated the money had been collected, even though an amount and a date were not shown; when as a matter of fact in some cases the wavy line meant the payment had been made, and in other cases meant that it had been written off, and that it was impossible to determine by looking at the card whether the wavy line

meant the money had been collected or had been written off; and that the word "credit" written on the card did not necessarily mean that the money had been collected; and there were occasions when the card was marked "paid" when it meant it had been written off or had been uncollectible, and stamped to get it out of the file; and that the wavy line in some instances meant it had been cancelled to that date, as the patient was not able to pay; and that it could not always be determined the year in which the payments were made, because of inadequate records; and there were occasions where a card indicated that the patient had paid the amount shown on the card, when in fact the patient admitted that the amount had not been paid and was still owing. [Tr. of R. pp. 399-419, 429-430, 461-467, 472-475.]

The Hill Report does not consider the report of payments made to other doctors by the petitioner in connection with patients who had been referred by the other doctors. [Tr. of R. pp. 419-422.]

The Hill Report shows one of the greatest amount of gross receipts for 1944, notwithstanding the fact that the petitioner did not practice for four months during that year. [Tr. of R. p. 433; Ex. V.]

The petitioner declared that the card records were incorrect. [Tr. of R. pp. 429-430.]

Revenue Agent Ness made a thorough search for other assets, but did not find any not listed in petitioner's net worth statement. [Ex. 1; Tr. of Rec. pp. 425-426.]

Prior to coming to California, judgments were obtained against petitioner in Florida and there were lawsuits against the petitioner. [Tr. of R. p. 140.]

Petitioner practiced medicine in Florida, operated a hospital and practiced in Montana, and commenced practicing medicine in California in 1936. [Tr. of R. pp. 141-143.]

The petitioner was very busily engaged in practicing medicine, and worked long hours. [Tr. of R. pp. 150-151.]

When petitioner purchased a home in California in 1936 it was taken in the cousin's name because petitioner was always being sued and he did not dare have anything in his name. [Tr. of R. pp. 159-161.]

Property was placed in the names of nominees for the purpose of convenience in handling, because of difficulties petitioner was having with his wife, because of lawsuits and judgments against petitioner. [Tr. of R. pp. 186-188, 204, 218-219, 221, 296-297, 308, 433.]

Mr. Lippman cashed checks totalling $65,000.00 for petitioner, as petitioner did not want it to be traced to him because of his involvement in lawsuits. [Tr. of R. p. 237.]

Federal District Judge Leon Yankwich in passing sentence on petitioner after his plea of *nolo contendere* to two counts of violating Section 145(b), Internal Revenue Code of 1939, representing the years 1947 and 1948, found that petitioner was a person who became involved because of his lack of experience in financial matters and his failure to surround himself with persons who, while petitioner was carrying on his work, would watch his finances and see that a proper report was made; and that in this particular case there is no such thing of a physician becoming involved in income tax difficulties because of resorting to unethical practices. [Ex. 4.]

The petitioner, Richard Douglas Furnish, contends that in the absence of a showing of fraud, the deficiencies in income tax (subject to minor adjustments pertaining to two automobiles and Thomas Steel dividends) are as follows:

Year	Tax	Deficiency
1944	Income	$ 3,526.66
1945	Income	18,812.00
1948	Income	27,808.85
1949	Income	5,577.02
	Total	$55,724.53

[Stip. of Facts, Item 2.]

If the respondent has successfully sustained the burden of proof of establishing fraud, the petitioner, Richard Douglas Furnish, contends that the deficiencies in income tax and penalty (subject to minor adjustments pertaining to two automobiles and Thomas Steel dividends) are as follows:

Year	Tax	Deficiency	50% Penalty
1939	Income	$ 3,378.85	$ 1,689.43
1940	Income	17,641.28	8,820.64
1941	Income	22,285.78	11,142.89
1942	Income	27,901.73	13,950.87
1943	Income and Victory	10,210.87	5,105.44
1944	Income	3,526.66	1,763.33
1945	Income	18,812.00	11,487.81
1946	Income	18,009.54	9,004.77
1947	Income	41,467.93	20,733.97
1948	Income	27,808.85	13,904.43
1949	Income	5,577.02	2,788.51
	Totals	$196,620.51	$100,392.09

[Ex. 2.]

Specification of Errors.

1. The Court erred in using the Hill Audit [Ex. V] for the purpose of determining the correct amount of taxable income, instead of petitioner's net worth statement. [Ex. 1.]

2. The Court erred in holding that the respondent sustained its burden of proof of establishing fraud.

3. The Court erred in holding that the deficiencies were not barred by the Statute of Limitations with the exceptions of the years 1944, 1945, 1948 and 1949.

4. The Court erred in receiving in evidence the Hill Audit. [Ex. V.]

Questions Presented by Appellant.

1. Is the correct amount of taxable income provided for more accurately by petitioner's net worth statement [Ex. 1] than the Hill Audit [Ex. V]?

2. Did the respondent sustain its burden of proof of establishing fraud?

3. In the absence of fraud, are all deficiencies barred by the Statute of Limitations excepting the years 1944, 1945, 1948 and 1949?

4. Did the Court err in receiving in evidence the Hill Audit [Ex. V]?

ARGUMENT.

I.

The Correct Amount of Taxable Income Is Provided More Accurately by Petitioner's Net Worth Statement.

The determination of taxable income is more accurately reflected by the net worth statement [Ex. 1] and the computation of tax [Ex. 2] than the Hill Audit [Ex. V] relied on by respondent.

It should be noted that all items of property carried in the names of nominees are included in the net worth statement so that the net worth statement reflects all of the assets of the petitioner with the exception of certain minor adjustments pertaining to two automobiles and dividends from Thomas Steel Corporation. [Tr. of R. pp. 169-172, 206, 216.]

The auditor who prepared the net worth statement succinctly points out the logic of relying on the net worth statement when he states that the Doctor had to have money in order to spend it. [Tr. of R. pp. 243-245.] It is not reasonable to assume that the petitioner acquired all of the money in any one year immediately prior to its expenditure. For example, the real property and improvements increased from approximately $14,000.00 at the end of 1943 to approximately $81,500.00 at the end of 1944, a difference of $67,500.00. During that same year his schedule of investments increased from approximately $34,000.00 to $61,000.00, a difference of $27,000.00, making a total increase of $94,500.00. It would not appear to be reasonable to assume that the $94,500.00 was all acquired during the previous year,

but it is more logical to believe that it is the result of an acquisition of cash over a number of years.

It should be noted that the investment schedule increased from the end of 1942 from approximately $7,500.00 to $34,000.00 at the end of 1943, or an increase of $26,500.00. The same reasoning applies.

The schedule of real property and investments increased from approximately $81,500.00 at the end of 1945 to approximately $192,000.00 at the end of 1946, or an increase of $110,500.00. Surely the respondent does not argue that there was an increase in the acquisition of cash of $110,500.00 for the previous year so as to be able to acquire the real property indicated.

An inspection of the summary of assets contained in the net worth statement indicates it is far more logical to assume the petitioner had acquired cash over a period of years in order to acquire the assets shown in the various schedules than to believe the cash was obtained within the year immediately preceding the acquisition of the specific items.

There does not appear to be a valid reason for doubting the petitioner's report of cash on hand, in view of the proof of expenditures by the petitioner. [Tr. of R. p. 249.]

The reports submitted by the petitioner's accountant when preparing the net worth statement were accepted by the respondent. [Tr. of R. pp. 258, 264.] An exhaustive search was conducted by the accountant, even to the point of getting information concerning government bonds and checking with agents of the government. [Tr. of R. p. 265.] All possible investments were checked. The accountant had the assistance of the petitioner, who told the accountant of certain items which

would not have been known except for the information given by the petitioner. The Internal Revenue Service did not discover any investments in addition to those reported in the net worth statement. [Tr. of R. p. 266.]

No objections were made by the respondent pertaining to schedules submitted by petitioner's accountant in the net worth statement. [Tr. of R. pp. 258, 264, 275-276, 279, 281-284, 287-288.] Needless to say, the Internal Revenue Service through its various agencies conducted a most intensive investigation into the affairs of the petitioner. There was a criminal case in addition to the civil action. The full facilities of the Federal Government were available to the respondent, and judging from the work that was done by the respondent in this case, it is only natural to assume that if there were any additional assets belonging to the petitioner, the respondent would have located at least one. Internal Revenue Agent Ness testified that a diligent effort was made to find any other possible assets, and none was found. [Tr. of R. pp. 425-426.] Therefore, we have every right to believe that in the absence of any such discovery, the petitioner's net worth statement, other than minor adjustments, is an accurate accounting of the assets of the petitioner as they were acquired over the years in question.

Usually the respondent prepares a net worth statement and relies on it for the purpose of establishing the income tax liability of a taxpayer. It is significant that the same method was used by the petitioner's accountant in preparing the net worth statement as is customarily employed by the Internal Revenue Service when it prepares a net worth statement on which it intends to rely. [Tr. of R. pp. 426-427.]

To rely on the method used by the respondent to determine the taxable income of the petitioner would be resorting to conjecture and surmise of the worst order. It is clear from the testimony of witnesses who were familiar with the records of the petitioner that one could not determine from an inspection of the record whether an item was paid or whether the patient was merely given a credit without any payment having been made.

Sometimes a wavy line indicated that the amount had been paid; sometimes it indicated that the patient was given a credit; sometimes the word "paid" meant the item was collected; sometimes it meant the account was merely closed out or written off; on occasions, cards of patients had a notation that the account was paid when in reality the patient came in and stated that there was money still owing to the petitioner; there were instances when a patient was not financially able to pay, and a wavy line was drawn to indicate not to send any more statements; the word "paid" could mean it had been written off or had been uncollectible and stamped to get it out of the file. [Tr. of R. pp. 461-466, 472-474, 400-419.]

Agent Ness in making his spot check of the Hill Report used the same method of determining payments as was used by Mr. Hill. It therefore follows that his spot check was of no significance because he engaged in the same surmises and conjectures as Mr. Hill did. He assumed that every wavy line meant the items had been collected; he assumed that every time the word "paid" appeared it meant the patient had paid the bill; he assumed that all items were collected whenever the same type of entry was made as was made when the obligation actually had in fact been collected; whereas the truth of

the situation is that many patients were unable to pay and the employees of the petitioner did not keep accurate records of the accounts between the petitioner and his patients.

Another fallacy of the Hill Report is that for the year 1944 it shows one of the largest collections of the years in question, when as a matter of fact the petitioner did not even practice medicine for four months during that year. [Tr. of R. p. 433.] As the petitioner stated to Revenue Agent Ness, it was not humanly possible for one man with the class of patients the petitioner had to do as much business as the Hill Report showed. [Tr. of R. p. 429.]

Petitioner agrees to adjustments of $500 for 1941 and $900 for 1944 because of gifts of two automobiles, and that a further adjustment should be made of $2,592.00 of Thomas Steel dividends received and retained by Mrs. Sullivan during the year 1948. These are adjustments that can be considered on a redetermination of tax when the decision of the Court is rendered.

II.

Respondent Has Not Sustained Burden of Proof of Establishing Fraud.

Title 26, Section 7454 of the *United States Code* provides that in any proceeding involving the issue of whether a petitioner has been guilty of fraud with intent to evade tax that the burden of proof in respect to such issue is upon the respondent.

In the case of *Wisely v. C. I. R.,* 185 F. 2d 263 (C. C. A. 6th, 1950), the Court held that the finding of the Commissioner of Internal Revenue that the taxpayer, a physician who was assessed with penalties, was guilty

of filing false and fraudulent income tax returns was clearly erroneous. In the *Wisely* case the taxpayer, who was a physician, was personally busy to the point of distraction and the Court held that it was vitally material. The Court's opinion states that fraud must be an actual intentional wrongdoing and that the intent required is a specific purpose to evade tax believed to be owing. The Court further held that mere neglect does not establish either, and that fraud must be established by clear and convincing proof. In the *Wisely* case a receptionist and a technician did the banking for the physician. Enough money was kept on deposit in the bank to pay expenses. The physician would occasionally take money from a safe and put it into a bank safety deposit box from which he would make withdrawals. Notwithstanding these facts, the Circuit Court reversed the Tax Court on the question of fraud.

The Tax Court, in the case of *D. York v. C. I. R.*, 24 T. C. 742 (1955), held that unexplained bank deposits are not in themselves clear and convincing evidence that the income tax return was false and fraudulent with intent to evade taxes. In the *York* case the taxpayer had reported wages of $2,950.00 and kept no books. There was an understatement of income which was shown by various bank transactions amounting to a net of $6,100.00. The Tax Court ruled that the petitioner must have had funds in order to make an investment in the liquor business before he had a bank account, and that the failure of the petitioner to explain the deposits did not make up the deficiency in the Commissioner's evidence to sustain the burden of proof of fraud.

Fraud implies bad faith, intentional wrongdoing and a sinister motive and is never imputed or presumed and a

Court should not sustain findings of fraud on circumstances which at most create only suspicion.

Davis v. C. I. R., 184 F. 2d 86 (C. C. A. 10th, 1950), 22 A. L. R. 2d 967.

"Fraud," authorizing imposition of penalties against taxpayer who attempts to avoid tax liability, is actual intentional wrongdoing, and intent required is a specific purpose to evade tax believed to be owed.

Guaranty Trust Co. v. United States (D. C. Wash., 1942), 44 Fed. Supp. 417, aff'd 139 F. 2d 69.

While determinations of the Commissioner are presumptively correct and the burden is on taxpayer to disprove them, burden is upon Commissioner to show fraud, and such burden is not sustained by merely establishing a deficiency.

Cohen v. C. I. R. (C. A. 10, 1949), 176 F. 2d 394.

Where tax case involved issue of whether return was fraudulent, there is no presumption to be indulged in favor of Commissioner's determination, and burden to establish charge of fraud is upon him.

Goldberg v. C. I. R. (C. C. A. 1938), 100 F. 2d 601, cert. den. 59 S. Ct. 793; 307 U. S. 622; 83 L. Ed. 1501.

Where income tax deficiencies had not been timely assessed and, but for proof of fraud, all such deficiencies except that for last year in controversy would have been barred, Commissioner of Internal Revenue had burden of proving, by clear and convincing evidence, that decedent had filed false and fraudulent returns.

Lee v. C. I. R. (C. A. Ga., 1955), 227 F. 2d 181, cert. den. 76 S. Ct. 1048, 351 U. S. 982.

When we consider the petitioner's background and the reasons which prompted him to place assets in the names of nominees, it can be readily seen that the respondent has not sustained the burden of proof which the statute and the decisions of the Courts require.

This is clearly the case of a doctor who thought more of practicing medicine than anything else; he was busy morning, noon and night looking after his patients. [Tr. of R., pp. 150-151, 298.] He was plagued with judgments obtained in Florida, lawsuits and difficulties with his wife extending over a period of years which culminated in an interlocutory decree of divorce on December 11, 1944.

He was so preoccupied with the practice of medicine that he allowed his business manager to handle the bank accounts and to take property in his name. There is nothing unusual about this. The bank accounts showed in the name of the business manager in his capacity as business manager or as trustee, and the address given was the office address of the petitioner. It is common practice for physicians and surgeons to allow their business managers to handle their bank accounts and financial matters. Properties taken in the name of the business manager included the petitioner's office building and an apartment house which the petitioner had in mind converting into a hospital. The petitioner did not wish to be bothered with the details of the escrows in either purchasing or selling, and therefore permitted his business manager to take title.

It is significant that in every instance where a nominee was used it was done because of judgments, lawsuits, or marital difficulties, or for the sake of convenience. [Tr.

of R., pp. 140-141, 159-160, 184, 186-188, 204, 218-219, 221, 237, 297, 308.]

The pattern of taking property in the name of a nominee was demonstrated as early as 1936, which is the first year the petitioner practiced medicine in California and years before the respondent contends there was any deficiency in income taxes. It will be recalled that the home the petitioner purchased in 1936 was taken in name of his cousin. [Tr. of R., pp. 159-160.]

It is common knowledge the layman is under the impression there is 25% income tax on long-term capital gains. People have become "capital gain" conscious because they have heard it is advantageous to make a capital gain rather than receive straight income as "you only have to pay 25% of the capital gain if the asset is held more than six months."

Oftentimes, a little knowledge is dangerous. The Court recognizes that the "25% tax" does not necessarily apply. The rate of tax paid by a taxpayer as a result of capital gains depends on his deductions and total taxable income. Therefore, it should not be held against the petitioner that he believed the full tax on a capital gain was paid when the nominee reported the sale of property and paid the tax. It is true the petitioner was wrong in assuming the full tax was paid. But petitioner's error in judgment does not sustain respondent's burden of proof to show fraud. It is respectfully suggested that there is a very small percentage of people who know or understand that the full tax is not necessarily paid by reporting a capital gain and paying the "25% tax". In the instances where sales were made in the names of nominees the presumed capital gain tax was paid. Neither the petitioner

nor the nominees thought otherwise until the investigation by the Internal Revenue Service was launched.

By the same token, the failure to include the Thomas Steel stock dividends of 1948 in the petitioner's income tax return is not a showing of fraud. Here again it is natural to assume and believe a taxpayer honestly thought that the person who actually received the income is the one required to pay the tax. In this case Mrs. Douglas received the dividends on the stock, kept the dividends, and used the dividends, even though she was the nominee of the petitioner insofar as the ownership of the stock is concerned. Mrs. Douglas paid the tax on the dividends and there was no intent to defraud the government. [Tr. of R., p. 220.]

The witness relied on by the respondent to furnish the damning or incriminating evidence to show fraud on the part of the petitioner was Herman Duelke. It was Duelke who would have this Court believe the petitioner stated he had removed records, was not worried about an investigation by the Internal Revenue Department, and that the Internal Revenue Department had previously invesitgated him. However, Duelke's credibility collapses when we consider the testimony of Edward Anspach, a disinterested witness.

It will be recalled that Mr. Anspach testified Duelke attempted to sell the Hinton Arms Apartment house under a power of attorney Duelke held. An agreement was executed by Duelke for the sale of the apartment house at a minimum figure of $65,000.00, when Mr. Anspach had a customer ready to buy the place for approximately $115,000.00. When the petitioner heard of it, he was disturbed and said he would not sell, although he offered to pay Mr. Anspach for any loss of commission he might

have sustained. The next week Mr. Anspach learned that Mr. Duelke was no longer with the petitioner. [Tr. of R., pp. 388-392.] But Mr. Duelke denies Mr. Anspach's testimony *in toto*. Duelke's testimony was so palpably false that he carried it to the extreme of saying he told Mr. Anspach the petitioner was the owner of the Hinton Arms Apartments because the question came up as to whether the petitioner owned the property. The Court was prompted to ask: "Why would that question have been relevant?" To which the witness replied: "I don't know." [Tr. of R., pp. 451-456.]

The petitioner may have hidden assets because he was afraid of creditors and holders of judgments. He may have been interested in not wanting his wife to know how much property he owned. He may have misunderstood the effect of the "25% capital gains tax"; he may not have known of his obligation to pay an income tax on dividends received and retained by a nominee; he may have been secretive; his office staff may have kept a poor bookkeeping system; but the evidence falls short of sustaining the burden of proof required of the respondent to show that the petitioner was guilty of actual intentional wrongdoing with the specific intent to evade federal income taxes.

The testimony of Duelke regarding his conversation with the petitioner about a previous income tax investigation falls of its own weight when we consider that Duelke was employed by the petitioner from November, 1945 to May, 1947, and the two income tax investigations were one in 1948, which was after Duelke no longer worked for the petitioner, and the other investigation was in 1945 covering two previous years for which no increase in income tax liability resulted, and was a mere audit.

Counsel for petitioner is fully aware of the case of *Mitchell v. C. I. R.,* 303 U. S. 391, wherein the Court held that an acquittal of income tax violation does not prevent the imposition of the 50% fraud penalty.

Petitioner contends, however, that the statement by Federal District Judge Leon Yankwich constitutes an express finding that there was no fraud on the part of petitioner, and in particular for the years 1947 and 1948, which were the two years involved in the criminal prosecution, and to which charges he entered a plea of *nolo contendere.* Judge Yankwich stated:

> "This case is different from the usual one involving a physician. Many a time a physician involved in income tax difficulties is one who resorts to unethical practices, and who then tries to cover them up by covering up his income tax. In this particular case there is no such thing. There is no income indicated from any improper sources. This is really the case of a person who has become involved because of his lack of experience in financial matters and his failure to surround himself with persons who, while he is carrying on his work, would watch his finances and see that proper report is made. . . ." [Ex. 4.]

Accordingly, it is respectfully urged that the respondent has not sustained the burden of proof to establish the required fraudulent intent on the part of the petitioner.

In this connection it should be noted that Mrs. Funk, the co-petitioner, is involved in these proceedings by virtue of the respondent's contention that there were joint tax returns filed for the years 1939 to 1942 inclusive, and that a finding of fraud as to the petitioner, Richard Douglas Furnish, would cause the petitioner, Emilie Funk, also to be held responsible for those years. If fraud is

not established for the years 1939 to 1942 inclusive, the respondent's case against the co-petitioner, Emilie Funk, falls, as the deficiencies would be outlawed by the Statute of Limitations. [Stip. of Facts, Item 2.]

III.

In the Absence of Fraud All Deficiencies Are Barred by the Statute of Limitations, Excepting the Years 1944, 1945, 1948 and 1949.

Consents extending the statute of limitations were timely filed for the years 1944, 1945, 1948 and 1949. The record does not disclose any extension for the other years involved. [Stip., pars. 1 and 2; Consents attached to Exs. D, E, and I; Ex. W; Ex. A of Petition in Docket 51417.]

Therefore unless fraud is established, the only years for which a deficiency may be upheld are 1944, 1945, 1948 and 1949. Under petitioner's net worth statement (subject to adjustments for two automobiles and Thomas Steel dividends) the deficiency would be $55,724.53. [Stip., Item 2.]

Under the respondent's theory of the Hill Audit, the deficiency for the four years would be $147,114.76. [Tr. of R., p. 113.]

IV.

The Hill Audit [Ex. V] Should Not Have Been Admitted in Evidence.

Objections were made to the introduction of the Hill Audit [Ex. V] on the grounds that the proper foundation was not laid to establish its accuracy, or the manner in which the report was compiled. [Tr. of R., p. 366.] The objections were overruled and the exhibit was received in evidence. [Tr. of R., p. 367.]

It is significant that neither Mr. Hill who prepared the report nor anyone who may have assisted him in compiling the report was called as a witness.

To rely on the Hill report as a means of determining the tax liability of the petitioner, is to depend on conjecture and surmise of the worst order. It is clear that one could not determine from an inspection of the patient's record card, whether an item was paid or whether a patient was merely given credit without a payment having been made. Yet it is the patient's record card that was used as the basis for the Hill report. [Tr. of R., pp. 461-466, 472-474, 400-419.]

Proof of the fallacy of the Hill report is that the year 1944 shows one of the largest collections, when as a matter of fact, the petitioner did not practice medicine for four months during that year. [Tr. of R., p. 433.] The unreliability of the Hill report is set forth more particularly in the Argument of Point I of this Opening Brief.

Conclusion.

It is respectfully urged that the net worth statement should be used as the basis for determining the tax deficiency. If that is done, then in the absence of fraud (subject to adjustments for two automobiles and Thomas Steel dividends) the deficiency should be $55,724.53 for the four years not barred by the statute of limitations. [Stip., Item 2; Ex. 2.]

In the event the Court determines that fraud was established, then the deficiency, subject to the same adjustments, should be $196,620.51 with a penalty of $100,392.09. [Ex. 2.]

Murray M. Chotiner,

Attorney for Petitioner, Richard Douglas Furnish.

APPENDIX.

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